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ABSTRACT

A year-long study of telecommunications policies and regulations in nine states--Texas, California, Florida, Illinois, Nebraska, New York, Vermont, Virginia, and Washington--found that these states tend to be more flexible in their telecommunications regulation than other states, although the process for achieving this flexibility has tended to reflect each state's individual "personality." While these different approaches might provide "experiments" from which to select the best policies, too much difference between state policies might also make it difficult for large telecommunications companies to coordinate their activities. It also found that, although telecommunications policy initiatives were often tied to economic development, the reverse was not always true; however, the direct relationship between the two conditions needs further research. Threats to universal service are often the major counterargument to regulatory flexibility, and further attempts should be made to reach agreement among telecommunications companies, consumer groups, and policymakers on a definition of basic service that would satisfy the goal of universal service in an efficient manner. The states which were studied have discovered, or are discovering their importance as telecommunications users, and these states should initiate, or continue to develop, long range plans for telecommunications use. (EW)

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TELECOMMUNICATIONS AND ECONOMIC DEVELOPMENT: A NEW STATE ROLE

By Frederick Williams
Jurgen Schmandt
Robert Wilson

A study of nine states shows an increasing diversification of telecommunications policy-making in this post-divestiture era. The states (California, Florida, Illinois, Nebraska, Texas, New York, Virginia, Vermont, and Washington) were selected for their current moves toward regulatory flexibility. In many cases, policy-making is involving state legislatures and special committees in addition to traditional regulatory bodies. Initiatives for regulatory flexibility often cite economic development as a key motive. This research reports upon the different initiatives in the nine states and the approaches to state-level policy-making. The project was jointly undertaken by the LBJ School of Public Affairs and the Center for Research on Communication Technology and Society, both of the University of Texas at Austin. It was supported by grants from Southwestern Bell and the Texas Telephone Association.

Introduction

Since the Communications Act of 1934 and until the divestiture of AT&T in 1984, the main regulatory role of the states was to set the rates for local telephone services and to insure "universal" availability of affordable service in urban and rural areas. With the exception of various independent telephone companies, mostly this meant dealing with AT&T-owned local companies, at one time 22 in number. Intrastate as well as interstate long distance was also mainly served by AT&T. Upon divestiture, local telephone ("exchange") services were defined within "local access and transport areas" (LATAs, for short; similar to standard metropolitan statistical areas), where it was thought that a regulated monopoly would best serve public needs as well as allow for company growth. Local exchange companies became certificated for a given area and, in turn, were subject to regulation. The divested Bell companies were reorganized into seven regional holding companies. These companies could also own selected unregulated businesses but must not subsidize them from the regulated side of their activities. Intrastate ("interexchange") long distance services, by contrast, were deregulated except for the "dominant" carrier, AT&T. Here it was argued that when it could be demonstrated that sufficient competition existed, AT&T could be deregulated or detariffed. This decision, to date, has largely been left to the states.

Telecommunications is big business -- estimated at around $600 billion annually worldwide, and growing. Expansion is due, in part, to the development of advanced technologies, but more so to the growing importance of the telecommunications infrastructures in modern business and governmental services. It is no wonder that with the size and growth of the telecommunications business, its increasing alliance with computer technology, plus the inherent relevance of both to the new "information" economy, that initiatives for regulatory flexibility now often include goals for economic development. This may be in the form of using telecommunications services to attract or provide growth incentives to businesses, to retain existing businesses, or to increase productivity of state agencies. In the course of the project we identified "telecommunications

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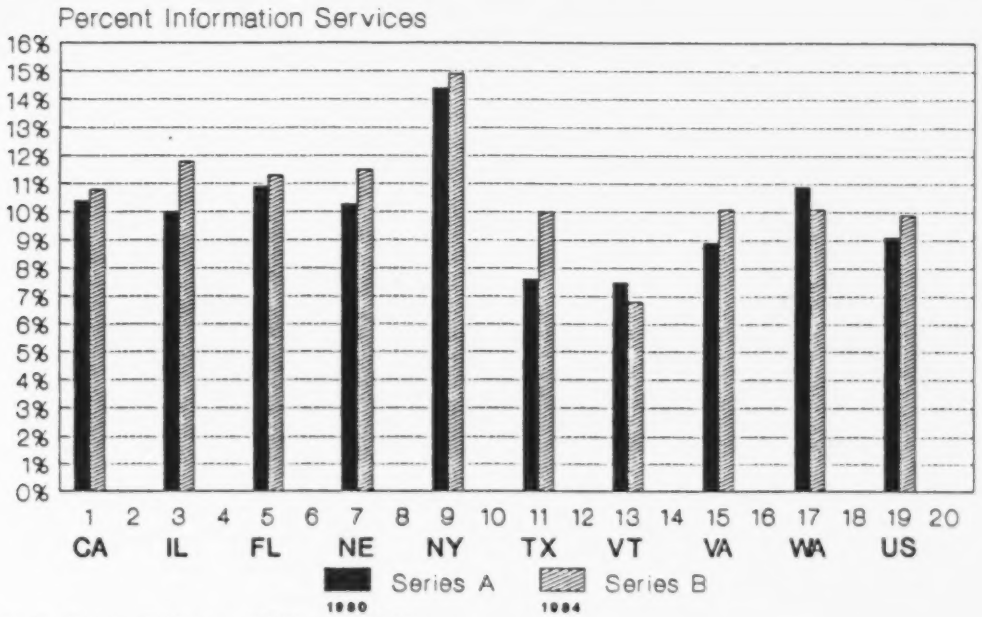
intensive businesses," or those organizations thought especially dependent upon such services and sensitive to capabilities of the telecommunications infrastructure. In the major report, these businesses are identified by SIC categories within information services, information technology equipment, research and development and media. The following chart summarizes the relative sizes of these businesses in the states studied.

SHARE OF INFORMATION SERVICES IN STATE ECONOMIES

(Figure by John Horrigan)



County Business Patterns, 1980 and 1984

Pressure for Change

Much of the pressure for regulatory flexibility at the state level is a consequence of telecommunications companies trying to position themselves in the post divestiture era. There is an emerging agenda for newly aggressive Baby Bells, AT&T and other common carriers ("OCCs"), as well as equipment and service providers. The companies frequently argue that there is a competitive environment for many markets and, consequently, regulation based on a natural monopoly unnecessarily constrains the market. Not only has this put pressure on regulators, but in many cases the arguments for change have been taken directly to the state legislatures, resulting in an increased politicization of issues.

Another factor contributing to change is that with divestiture came the industry's assumption that prices would be driven toward costs, meaning, among other things, that the long-time subsidization of local rates by long distance rates would be lessened or abolished altogether. Interexchange and long distance companies want to accelerate this process; local exchange companies naturally tend to resist it. Again, a frequent argument for policy change at the state level has been regulatory flexibility for reasons of economic efficiency or development, not only

for telecommunications providers and users, but for improving state attractiveness for business recruitment or re.ention. The presumption is that an efficient and advanced telecommunications infrastructure enhances the business environment of a state. The counter-argument that regulatory relaxation threatens the ability to guarantee universal service (especially with low rates) is being defused with the offering of various types of financial assistance programs to consumers who might be forced off of the network by higher local rates.

A Study of Nine States

This report presents the results from a year-long project involving three faculty and seventeen graduate student researchers (see end note). We sought to answer such questions as: What distinguishes states as telecommunications policymakers? How much flexibility have they allowed? What types of links are proposed between telecommunications policy and economic development? What are relations between economic development initiatives and universal service? What are states doing to improve their own uses of telecommunications? In addition to Texas, eight states were selected for detailed study. They included California, Florida, Illinois, Nebraska, New York, Vermont, Virginia and Washington. These represented rural and urban states, variations in regulatory change, and local exchange companies operating under each of the seven regional holding companies.

Conclusions and Recommendations

Our findings and recommendations can be summarized in four major areas:

1. States as Telecommunications Policymakers:

The table below shows how the nine states now differ in regulatory flexibility. These states, as a reflection of our reason for choosing to study them, are generally more flexible than the remaining 41 (although some are in the process of change).

TABLE: REGULATORY FLEXIBILITY OF THE NINE STATES

	TRADITIONAL RATE OF RETURN			PRICING FLEXIBILITY			NEW SERVICE FLEXIBILITY		
COMPANIES/ STATES	B.O.C.	AT&T	OCCs	B.O.C.	AT&T	OCCs	B.O.C.	AT&T	OCCs
CALIFORNIA	yes	yes	yes		limited		yes	yes	yes
FLORIDA	yes	yes	yes	yes	yes	n.a.	yes	yes	n.a.
ILLINOIS	yes	no	n.a.	yes	yes	n.a	yes	yes	n.a.
NEBRASKA	no	no	no	yes	yes	yes	yes	yes	yes
NEW YORK	no	no	no	limited	limited	yes	no	no	no
TEXAS	yes	yes	no	no	no	yes	pending	pending	yes
VERMONT	yes	n.a.	yes	pending	n.a.	yes	pend.	n.a.	yes
VIRGINIA	yes	no	no	no	yes	yes	no	yes	yes
WASHINGTON	yes	no	no	yes	yes	yes	no	yes	yes

"Flexibility" is defined as some form of expedited hearing procedure other than a traditional adjudicatory one.
B.O.C. is Bell operating company; O.C.C. is other common carriers.
(Prepared by Philip Treuer.)

The process for achieving this flexibility has tended to reflect each state's "personality." States are striking out in somewhat different directions, reflecting their economic styles and political cultures. For example, Virginia has its "gentleman's agreement," Vermont a "social contract," and Illinois its "market led" initiatives.

On the one hand, the different state approaches may be providing us with "experiments" from which we can select the best policies. For example, what is the consequence of deregulation of interexchange services as in Nebraska and Virginia? But on the other, differences among states may become so great that it will become overly burdensome for large telecommunications companies to coordinate their activities, and these costs will be passed along to customers. A growing provincialization of telecommunications regulation can further blur any focus we currently have for a nationally oriented telecommunications policy (including direction given to Judge Harold Greene in whose court the process of divestiture continues to be overseen). There is reason to believe also that as some regulatory interpretations and new policies are developed in an adversarial context -- as tends to be the case in Texas -- a state may be losing advantages it could gain from longer range and consensus-oriented planning. By focusing debate on narrow grounds, adversarial proceedings typically fail to bring attention to a level of global issues. Our recommendation is that telecommunications policy-making is becoming a sufficiently important need that should be the topic of high-level, consensus-building state committees or commissions, as, for example, is now developing in California. (The National Governors' Association is currently developing a policy statement that recognizes the importance of telecommunications in economic development and sets forth network modernization and technological innovation as policy goals.)

Finally, as regulatory changes do take place, we should have a more consistent and systematic study of the consequences. Many changes are being made with certain goals in mind, but in most states there is no formal mechanism for assessing progress toward those goals.

2. Links between Telecommunications and Economic Development:

Economic development has often been used as an argument for regulatory flexibility. After divestiture, deregulation in some states (e.g., Nebraska) became a fashionable term that some equated with innovation and hence economic development. Other states, although not denying a potential link, had a more cautious approach (e.g., California, New York). They were skeptical about the economic promises of rapid deregulation and concerned about the potential social impact on universal service. These states deregulated only those services where there was significant competition or they permitted flexibility through incentive regulation. Still others (e.g., Texas, Washington), in order to meet the challenges of the rapidly changing environment, enhanced the utility commission control and at the same time made moves toward flexibility.

Although telecommunications policy initiatives were often tied to economic development goals, the reverse was not always the case. That is, economic development programs, alone, in many of the states did not incorporate telecommunications initiatives. In either case, the economic goals were variously defined by different stakeholders. To telecommunications providers, development naturally means the health and growth of their own business and the businesses their services most directly impact. To economic development agencies, it means jobs and businesses gained for an area (as in Illinois), or safeguarding against their loss to another area (as in New York City). Or in Nebraska, telecommunications means new business opportunities (they call Omaha the "800 capital" of the world). In most states we studied, it was difficult to find data on the direct links of telecommunications promoting economic development. The general consensus has been that although telecommunications seems to be a fundamental infrastructure for the growth of many modern businesses, a state of the art telecommunications system alone is not a sufficient condition for growth. There were several examples (Florida, California) where one could clearly document how the reverse holds -- that is, how telecommunications growth has followed or kept pace with economic development. In either case, this is an area where continued research would be a

valuable policymaking tool. We need more studies that relate telecommunications -- especially policy alternatives -- to developmental goals.

In some states we studied (e.g., Texas, California), there was a lack of coordination among state economic development agencies, telecommunications planners, and regulators. The recommendation is that increased cooperation among telecommunications regulators, planners, and developmental agencies is an important priority for state action. Incentives for development of regulated telecommunications companies were found in new approaches for rate-making. For example, "social-contract" (Vermont) or "moratoria" (New York) types of agreements trade a fixed level of rates in return for a company to have more latitude for the level of profit it may realize. Fixed rate of return ("rate base, rate of return") methods of rate-making, which have been commonly used by state utility commissions in the past, incorporate few incentives for improving productivity. On the other hand, consumer advocates argue that because telecommunication is a declining costs industry, any benefits under flexible rate of return could unfairly fall to shareholders and not to rate-payers (at least in the absence of regulatory oversight).

3. Regulatory Change Relative to Universal Service and other Regulatory Issues:

Threats to universal service are often the major counter-argument to regulatory flexibility. Although this is clearly not true for all policy makers in all states, there is a fear that basic local phone service is threatened when local exchange companies get into competitive ventures. The potential for cross-subsidy between the unregulated and regulated parts of a telephone company exists. There is also a fear that local service, particularly in rural or poor areas, could be neglected. Further, if telecommunications providers include in the rate base the costs of installing advanced technologies, it may be the case that these services are of far more immediate benefit to large businesses than to small ones, or to residential customers.

However, we have found that the threat to affordable service (mainly keeping local rates low) is being countered by the willingness of telecommunications companies to support various types of financial assistance plans so that the poor, elderly, or handicapped are not forced off the network. One possibly negative consequence of this solution is that it may lessen the attention placed on keeping rates low through innovative options or new technologies. In addition, there may be substantial implementation costs for this solution, including, for example, the costs to fund activities necessary to qualify individuals for assistance and to prevent abuses of the program. Our recommendation is that further attempts be made to reach agreement among telecommunications companies, consumer groups, and policy makers on a definition for a basic service that satisfies the goal of universal service in an efficient manner. Although development and universal service remain important issues on the state level, they are not the only ones. Many of the states are attempting changes in telecommunications policy to respond to drastic changes in the telecommunications industry. Local exchange companies, once largely natural monopolies, are now engaged in both monopoly and competitive services which complicates the separation between the two. How to make and to monitor these separations is another problem faced by states. A related issue is rural-urban distinctions. States fear that since competition will be focused in the high density markets, rural areas will be neglected, their network quality will decline, and their rates increase. On the other hand, because telecommunications can make businesses non-location specific, some policy makers see telecommunications as a way to bring business to rural areas. Research into the role of telecommunications in rural development should be a high priority area (as is being conducted by sociologist Donald Dillman in Washington).

4. The State as a Telecommunications User:

Most states we studied have or are discovering the importance of themselves as telecommunications users. A state's service organizations can improve their productivity by uses of enhanced telecommunications. State planning as a user may also foster the state's telecommunications industry by purchasing services (and sometimes equipment) from in-state vendors. Also, by acquiring an advanced technology or service, a state can encourage its

acquisition by large commercial users. Finally, there are many examples of extending educational opportunities through telecommunications, a high priority in an era where a well-trained workforce, as well as continuing education, is a requisite for many new industries.

Our recommendation is that states initiate, or continue to develop, long range plans for telecommunications use, including integration of voice and data management, large-scale procurement policies, and specialized applications in management, human services, education, and law enforcement. There is much that states can learn from each other in this area; for example, the report of the Automated Telecommunications and Information Committee in Texas is a valuable guide.

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NOTE

Telecommunications and Economic Development: The New State Role was conducted as a joint "Policy Research Project" of the LBJ School of Public Affairs and the Center for Research on Communication Technology and Society (College of Communication). Seventeen graduate students from the two programs and three faculty conducted the research over a year's time. Frederick Williams is Director of the Center and also occupies the Mary Gibbs Jones Centennial Chair in Communication. He holds his graduate degrees from the University of Southern California. Jurgen Schmandt is Professor of Public Policy in the LBJ School and director of the Center for Growth Studies of HARC. His doctorate was earned from the University of Bonn. Robert Wilson, Associate Professor of Public Affairs in the LBJ School, earned his advanced degrees from Oklahoma State University and the University of Pennsylvania.

The research involved visits to each of the states, extensive interviews with regulators, telecommunications executives, and state officials. The results of the project were presented and further refined at a one-day conference held in April, 1988. The results will be published later this year as a book.

Student researchers included Janee Briesemeister, Darrick Eugene, Danny Garcia, Joellen Harper, John Horrigan, Larken Jennings, Amy Korzick, David McCarty, Darren Rudloff, Sehba Sarwar, Harmeet Sawhney, Kerry Strayer, Philip Treuer, David Twenhafel, Mahmoud Watad, and Benet Younger.

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